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In The

SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1958

No. 818

MARIE S. KIRKPATRICK, MARGARET S. HAYES, and J. H. PEARSON, Co-Administrators of Estate of N. B. Smithey, Deceased
Petitioners

versus

P. K. SANDERS, DISTRICT DIRECTOR OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

RAYMOND KYLE HAYES
Counsel for Petitioners

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P. K. SANDERS, DISTRICT DIRECTOR OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT:

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioners, Marie S. Kirkpatrick, Margaret S. Hayes, and J. H. Pearson, Co-Administrators of the Estate of N. B. Smithey, deceased, are seeking certiorari in

this case to review a decision of the United States Court of Appeals for the Fourth Circuit affirming a judgment of the District Court for the Middle District of North Carolina, Greensboro Division, A. D. Barksdale sitting by designation. Said judgment having been affirmed by the United States Court of Appeals for the Fourth Circuit on the 16th day of October, 1958, by Case No. 7673. A petition for rehearing was filed on October 23, 1958, and an order denying a rehearing was entered January 14, 1959. A petition for stay of mandate was filed and order staying the mandate has been entered.

The respondent is P. K. Sanders, District Director of Internal Revenue.

JURISDICTION

Jurisdiction of this Court is invoked under Title 28 USCA Section 1254 (1). The jurisdiction of the District Court is found in Title 28 USCA Sections 1340 and 1346.

STATEMENT

The petitioners contend that there was error committed by the trial court in denying the petitioners a jury trial on the issues involved and that the United States Court of Appeals committed error in affirming the action of the trial court and that the errors committed deprived the petitioners of their constitutional rights of jury trial on the issues as guaranteed to them by the Constitution of the United States.

That the Court's holding conflicted with the decisions of this Court as is shown by the cases hereinafter cited, in that

the court's holdings in this case set at nought the Gift Tax Statute of 1939, which was Title 26 U.S.C. Sections 1000 and 1001, and used Section 811, 1952 Edition, to force on the petitioners an unsolicited refund of gift tax paid in 1942 by the decedent in order to collect a much larger tax out of the decedent's estate after his death on September 3, 1953. The holdings of the Supreme Court of the United States as shown by the cases hereinafter cited are to the effect that the two statutes are pari materia.

The facts are as follows: On December 26, 1941, N. B. Smithey, who is the same person as Nike B. Smithey, and his wife conveyed a tract of land and building located thereon to their daughter, Marie S. Kirkpatrick, and another tract of land and building thereon to their other daughter, Margaret S. Hayes, by separate deeds of bargain and sale, reciting in the Kirkpatrick deed a consideration of One Hundred Dollars and other valuable considerations, and stamping the deed with revenue stamps in the amount required of the seller by the Internal Revenue Code of 1939. Said stamps were in the amount of $30 and initialed in the handwriting of the decedent, and which stamps denoted a consideration of $27,000.00.

The Hayes deed recited a consideration of One Dollar and other valuable considerations and the same was stamped with $26.00 worth of revenue stamps as required by the Internal Revenue Code of 1939, denoting a consideration of $23,000.00. The stamps were initialed in the handwriting of N. B. Smithey and dated 12-26-41. This deed was not recorded until after the death of N. B. Smithey in 1953.

Mr. Smithey was engaged in the operation of department stores on each of the pieces of property conveyed and had

been for more than ten years prior to the conveyances. Simultaneous with the execution of the deeds the grantor, N. B. Smithey, took from each of the grantees, with the joinder of their husband, a lease on the properties for a fifteen year period. The lease from Margaret S. Hayes was in force at the time of Mr. Smithey's death. The Kirkpatrick lease was modified prior to Mr. Smithey's death because of change of ownership of the business operated in the real estate, but the lease as modified was in effect at the time of the death of Mr. Smithey. The leases provided for the annual payment of rent by Mr. Smithey to the grantees in the deeds. It was shown in the trial that payment of the rent to the grantees was made annually.

The petitioners filed the Estate Tax Return and paid the tax to the Director in the amount of $338,489.24. Subsequent to this the Examiner made adjustments in the values and included in the estate the two pieces of property which the decedent had conveyed to his two daughters as above set out, and fixed a value of $35,000 on each of the properties, and made other additional assessments which they paid tax on in the amount of $98,429.05, or paid a total tax of $436,918.29. A timely refund was claimed for the tax paid on the two pieces of real estate conveyed to the decedent's daughters and the claim was denied by the Director. Suit was instituted for the tax in the District Court, said tax claimed being in the sum of $29,400 and interest thereon from the 19th day of June, 1955, in which suit the plaintiffs asked for a jury trial.

On the 3rd day of March, 1958 the trial was entered into, and at the close of the evidence the trial court gave the jury a peremptory instruction as is shown on page 33 of the Appellee's Appendix.

On March 9, 1942, Nike B. Smithey filed a gift tax return showing a total gift of $65,418.00. In that return he described the land contained in the Hayes deed and showed the date of the gift as 12-26-41, valued the building and lots at $23,918.00, and also showed that on 3-14-41 he gave $7,250.00 to her in cash. He described the Kirkpatrick lots and valued them at $27,000.00 and showed the date of gift as December 26, 1941. On March 14, 1941 he also showed a gift of $7,250.00 in cash. He exercised his right to give $4,000.00 to each individual during the year and left a net of $57,418.00 on which he used his specific exemption of $40,000.00, being his lifetime exemption, and left a net taxable gift for the year of $17,418.00, on which he paid the gift tax and defense tax thereon, and the gift tax return shows that the same was received on March 11, 1942. The donees filed similar information returns. The respondent sought to take advantage of a North Carolina Statute which is section 47-26, as follows:

> Sec. 47-26 of the 1950 General Statutes of North Carolina reads as follows: "All deeds of gift of any estate of any nature shall within two years after the making thereof be proved in due form and registered, or otherwise shall be void, and shall be good against creditors and purchasers for value only from the time of registration."

1. Can the Director take advantage of an alleged defect in a deed under the recording laws of the state to tax the property described therein as a part of the taxpayer's estate under the estate tax law in existence at the time of his death in 1953, when the taxpayer had filed a valid gift tax return and paid the tax due thereunder in 1942 on the identical property?

2. After the taxpayer had conveyed two tracts of land by deeds of bargain and sale reciting a valuable consideration, stamped with transfer revenue stamps, said deeds being dated December 26, 1941, and subsequently filed a gift tax return on March 9, 1942 describing the identical property, paid the gift tax due under the gift tax return, took from the grantees in said deeds a lease on said property providing for annual rentals which were paid to the grantee, is said property a part of the decedent's estate at the time of his death in 1953 and subject to the Director remitting the gift tax paid and taxing said property at a much greater rate as a part of the decedent's estate?

3. Can the Federal Courts construe a state statute in such a way as to deprive the plaintiffs of a jury trial when under the laws and holdings of the court of that state a jury trial would be required before judgment could be rendered against the plaintiffs?

4. May the government on any ground nullify the action of a taxpayer who has complied with the laws in force at the time of his action and undo his actions after the lapse of eleven years?

5. Is the gift tax statute and the estate tax statute equal in dignity and pari materia and does the payment under the gift tax statute, after the lapse of six years, prevent the Director from collecting estate tax on the identical property on which the gift tax was paid?

6. Is the General Statutes of North Carolina 47-26 (which statute was enacted to prevent fraud on creditors) available to the Director of Internal Revenue, enabling him to enforce an unsolicited refund of the gift tax on the decedent's estate in order to get a much larger estate tax?

REASONS FOR ALLOWANCE OF WRIT AND BRIEF IN SUPPORT THEREOF

The petitioners contend that the tax was paid in 1942 and that, although it is strenuously contended by the petitioners that the deeds for the two pieces of property in question were not gift deeds, if they were gift deeds the government having received the tax in 1942 should not be allowed to tax the same property in 1953 on the decedent's passing, and the petitioners say that the holdings in the United States Court of Appeals for the Fourth Circuit in this case conflict with the holdings of this Court in the hereinafter cited cases and creates uncertainty as to the effect of the Gift Statute complied with and would be setting a dangerous precedent by letting this decision stand and permitting the government to force on the petitioners an unsolicited refund for the purpose of securing a much larger tax out of the decedent's estate. That the decedent in 1942 exercised his lifetime right to give, which was the same as paying the tax thereon, and to permit the decision of the United States Court of Appeals for the Fourth Circuit to stand without a certiorari being granted would be to interfere with vested rights and to permit the decision to contradict the holdings of this Court in the cases hereinafter cited, and would not only permit the collection of two taxes on this property, for that he could not exercise his lifetime right at any time subsequent to the filing of the gift tax return of 1942, and the government could not refund an equal amount of the tax if it refunded all gift tax paid because the decedent was exercising his lifetime right to give as provided under the law as of 1942.

Sanford's Estate v. *Commissioner of Internal Revenue*,

60 S. Ct. 51, 308 U.S. 39, was decided November 6, 1939. and we quote the following headnotes:

"6. Statutes

The gift tax was supplementary to the federal estate tax, and the two are in pari materia and must be construed together. Revenue Act 1924, § 319 et seq., 26 U.S.C.A. Int. Rev. Acts, page 79 et seq.; Revenue Act 1926, § 302(d), 26 U.S.C.A. Int. Rev. Acts, page 228; Revenue Act 1932, § 501, 26 U.S.C.A. Int. Rev. Acts, page 580."

"10. Internal revenue

The gift tax statute does not contemplate two taxes on gifts not made in contemplation of death, one upon the gift when a trust is created, or when the power of revocation if any is relinquished, and another on the transfer of the same property at death because the gift previously made was incomplete. Revenue Act 1924, §§ 319 et seq., 322, 26 U.S.C.A. Int. Rev. Acts, pages 79 et seq., 82; Revenue Act 1932, § 501, 26 U.S.C.A. Int. Rev. Acts page 580."

The following is quoted from the opinion on page 57:

"We think, as was pointed out in the Guggenheim case, supra, 288 U.S. page 285, 53 S. Ct. page 370, 77 L.Ed. 748, that the gift tax statute does not contemplate two taxes upon gifts not made in contemplation of death one upon the gift when a trust is created or when the power of revocation, if any, is relinquished, and another on the transfer of the same property at death because the gift previously made was incomplete."

Burnet v. *Guggenheim*, 53 S. Ct. 369, 288 U.S. 280, was decided February 6, 1933, and we quote the following headnotes:

"2. Trusts

By executing deeds creating trusts, settlor divested himself of title and transferred it to others, notwithstanding reservation of power of revocation, although such power accompanying delivery would nullify gift.

"3. Statutes

When meaning is uncertain, statute will be construed so as to avoid unnecessary hardship.

"4. Internal revenue

Statutes imposing gift and estate taxes held in pari materia, as regards meaning of 'transfer' (26 USCA § 1091 et seq., and § 1131 note et seq.)"

We quote the following from the opinion on pages 370 and 371:

" - - - . Congress did not mean that the tax should be paid twice, or partly at one time and partly at another. If a revocable deed of trust is a present transfer by gift, there is not another transfer when the power is extinguished. If there is not a present transfer upon the delivery of the revocable deed, then there is such a transfer upon the extinguishment of the power. There must be a choice, and a consistent choice, between the one date and the other. - - - - - - Did Congress have in view the present payment of a tax upon the full value of the subject-matter of this imperfect and inchoate gift? The statute provides that, upon a transfer by

gift, the tax upon the value shall be paid by the donor - - - - - . A statute will be construed in such a way as to avoid unnecessary hardship when its meaning is uncertain - - -. Hardship there plainly is in exacting the immediate payment of a tax upon the value of the principal when nothing has been done to give assurance that any part of the principal will ever go to the donee. "The respondent invokes the rule that in the construction of a taxing act doubt is to be resolved in favor of the taxpayer. - - - - - .

"The tax upon gifts is closely related both in structure and in purpose to the tax upon those transfers that take effect at death. What is paid upon the one is in certain circumstances a credit to be applied in reduction of what will be due upon the other - - - - - . The two statutes are plainly in pari materia. There has been a steady widening of the concept of a transfer for the purpose of taxation under the provisions of part 1."

In the case of *Merrill* v. *Fahs*, 65 S. Ct. 655, 324 U. S. 308, decided March 5, 1945, Justice Frankfurter delivering the opinion for the court, stated:

"The guiding light is what was said in Estate of Sanford vs. Commissioner, 308 U.S. 39, 44, 60 S. Ct. 51, 56, 84 L.Ed. 20: 'The gift tax was supplementary to the estate tax. The two are in pari materia and must be construed together.' "

The appellants contend that under *Pierce* vs. *Stallings*, 163 N. C. 107, that the deceased could not set aside the conveyances for want of recordation and re-vest the lands in his estate. That the General Statutes of North Carolina

47-26 relates to creditors and the government could not take a greater right for the purpose of taxation than Mr. Smithey himself had. That in the first place the deeds were deeds of bargain and sale and no requirement to record within a two year period, but even if they should be found to be deeds of gift the Director could not avail himself of General Statutes of North Carolina 47-26, because that statute is not available to the Director but only to creditors and purchasers for value.

In the case of *Pierce* v. *Stallings*, 163 N. C. 107, it is held:

> "And in Saunders' case, supra, it was held: 'A conveyance made with an intent to defraud creditors is nevertheless valid against the maker and all others, except creditors and those who purchase under a sale made for their benefit; and until the title thus conveyed is divested by some proceeding instituted by the creditors, it is sufficient to support an action for the recovery of the land and damages for its detention.'"

We quote the following from Volume 148 of the American Law Reports page 228:

> "According to the decided weight of authority a grantor cannot recover property from a grantee who received it in fraud of creditors even though there was no consideration and no intention to make a gift. Most of the cases hold that when the grantor dies his heirs are in no better position to enforce a resulting trust arising from a fraudulent conveyance. Since this rule permits the unjust enrichment of a fraudulent trustee it is subject to many confusing exceptions. For example it has been held that where the purpose to defraud creditors

has failed of accomplishment the grantor can recover the property."

Therefore, if Mr. Smithey could not rescind these deeds, which we contend he could not, the government can not take a position better than his. The government was not a creditor and the General Statutes of North Carolina, section 47-26 is not available to it.

We quote from the case of *Wells Fargo Bank & Union Trust Company* v. *United States*, 80 F. Sup. 787, decided on November 4, 1948, and on page 790 it is held:

"III. Finality of Determination.

(3) The executors of the estate of the donor, Henry C. Morris, having paid the tax, the Commissioner of Internal Revenue can not, long after the payment of his demand, and within the five year period, change his position in order to collect from the plaintiff, as the executor of the estate of the donee, Mary E. Morris, an additional tax, upon the theory that he erred years before in assessing the prior tax and in accepting full payment of it."

"- - - . However, here we are not dealing with the right of further assessment. What the Commissioner is seeking to do is to force an unsolicited refund upon one estate in order to impose a greater liability on a later estate and deprive it of the benefit of the inclusion in the earlier estate of property which became a part of the later estate within the five year period. I do not believe that such unilateral action on the part of the Commissioner can nullify the effect of his actions in the earlier estate, so as to fasten upon the present

estate a liability which the former estate, following a re-assessment, had acquiesced in and satisfied fully."

The appellants say to let the judgment of the Fourth Circuit stand would be to give the Director the power in his own "good time" and at his own "sweet will" power to change his mind, offer to repay taxes without the asking, and recover a larger tax out of subsequent estates, or out of the same estate, and there could never be any finality of determination.

In the instant case the tax was paid in 1942, accepted by the Commissioner, audited and approved, and six years elapsed, yea eleven years elapsed, before the Commissioner undertook to refund the gift tax in order to collect additional tax under the estate tax provisions.

It will be noted as is pointed out in the petitioners' brief and supplemental brief in the Circuit Court that General Statutes of North Carolina, Section 47-26 is an enactment to prevent a fraud on creditors, and that deeds held by the courts to be gift deeds were deeds which recited a nominal consideration and love and affection, but consistently where the deeds recited a valuable consideration, although it be a small consideration, and were deeds of bargain and sale, and even in the cases reciting "love and affection", the courts of North Carolina have held that before the trial judge may declare them gift deeds that the jury answer the issue as to whether the deeds were deeds of gift or of bargain and sale. If the jury finds that they are gift deeds then automatically the law requires that they be recorded within two years from the date of execution. If not gift deeds there is no requirement as to registration within a specified time.

It will be noted from numerous citations that a deed reciting a valuable consideration under the North Carolina laws is prima facie evidence of consideration and the plaintiff having made out a prima facie case under the laws of North Carolina and in its courts are entitled to have the issue passed on by the jury, which the petitioners were deprived of in this proceedings in the lower court, and for the reasons assigned your petitioners respectfully contend that certiorari should be granted for the purpose of bringing this case before the court.

WHEREFORE, your petitioners pray that a writ of certiorari issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fourth Circuit, commanding the said Court to certify and send to this Court for its review and determination, as provided by law, this cause and a complete transcript of the record and all proceedings had herein; to the end that this case may be reviewed and determined by this Court as provided for by the statutes of the United States, and that the judgments herein of the Circuit Court of Appeals may be reversed and that the petitioners may have such other and further relief in the premises as this Court may deem appropriate.

Respectfully submitted,

RAYMOND KYLE HAYES
Counsel for Petitioners

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 7673.

Marie S. Kirkpatrick, Margaret S. Hayes, and J. H. Pearson, Co-Administrators of Estate of N. B. Smithey, deceased,
Appellants,

versus

P. K. Sanders, District Director of Internal Revenue Service of North Carolina,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO.

(Argued October 13, 1958. Decided October 16, 1958.)

Before SOBELOFF, Chief Judge, SOPER, Circuit Judge, and BRYAN, District Judge.

Kyle Hayes (Clyde Hayes on brief) for Appellants, and James P. Saunders, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General; Lee A. Jackson, Melva M. Graney, Attorneys, Department of Justice; James E. Holshouser, United States Attorney; and Lafayette Williams, Assistant United States Attorney, on brief) for Appellee.

SOBELOFF, Chief Judge:

The administrators of the estate of N. B. Smithey sued for refund of estate taxes paid by them upon a deficiency assessment. Their controversy with the District Director of Internal Revenue relates to two parcels of land which the Director included for estate tax purposes, but which they contend had been effectually transferred by the decedent to his two daughters in his lifetime. The Director maintains that the transfers were gifts, and because the deeds were not recorded within two years after execution in 1941, they were void under the applicable North Carolina statute.[1] Failure to record within two years is conceded, but the administrators insist that the deeds were not made as gifts but for a valuable consideration and that, therefore, the statute is inapplicable.

At the conclusion of the evidence, the District Judge, being of the opinion that there was no basis in the testi-

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[1] Sec. 47-26 of the 1950 General Statutes of North Carolina reads as follows: "All deeds of gift of any estate of any nature shall within two years after the making thereof be proved in due form and registered, or otherwise shall be void, and shall be good against creditors and purchasers for value only from the time of registration."

mony from which the jury could conclude that the deeds were other than gifts, directed a verdict for the defendant. The administrators, appealing, contend that there was an issue of fact which should have been presented to the jury.

On December 16, 1941, Mr. Smithey and his wife executed two separate warranty deeds, one conveying a parcel of real estate valued at $27,000.00 to his daughter, Mrs. Marie Smithey Kirkpatrick, and the second conveying real estate worth $23,918.00 to Mrs. Margaret Smithey Hayes, another daughter. The first of the deeds recited a consideration of $100.00 and "other valuable considerations"; the second, $1.00 and "other valuable considerations." Internal Revenue transfer stamps in the amounts of $30.00 and $26.00, bearing cancellation marks dated and initialed, "12/26/41 N.B.S.", were attached to the respective deeds. Shortly thereafter, the daughters leased back to the father the properties conveyed by the deeds, and he continued to operate his business therein and paid annual rentals of $900.00 on each property until his death in 1953.

In 1942, Smithey duly filed a federal gift tax return reporting gifts of the properties to his daughters, and they, in turn, filed corresponding "Donee Information Returns for Gifts."

The appellants argue that in North Carolina recitals of consideration in deeds are considered *prima facie* correct, *Randle* v. *Grady*, 32 S.E. 2d 20, 22, 224 N.C. 651 (1944), *Faust* v. *Faust*, 57 S.E. 22, 23, 144 N.C. 383 (1907), and that, therefore, the mention in the deeds of monetary and other considerations must be presumed to negate gifts in this instance, thus raising a jury question as to whether the properties passed for a valuable consideration.

However, on the entire record we think the District Judge was clearly correct in his view that no real issue of fact existed for the jury to consider, for the testimony permitted only one rational finding, namely, that the transfers were gifts.

The gift tax returns filed by Smithey and his daughters in 1942 clearly show that the parties regarded the transfers as gratuitous. While the internal revenue stamps may be considered some evidence of the value of the property, we think they have no evidentiary force in establishing the amount that was actually paid. A feature of the testimony noted by the trial judge is that the stamps could not have been attached to the deeds as early as purported, in December, 1941, because it was shown by the Chief of the Cashier's Branch of the Internal Revenue Service for North Carolina that the stamps were not printed until 1944. The daughters themselves negatived the inference suggested by the appellants, even if the stamps could be thought to indicate the amount of the actual payment. Mrs. Kirkpatrick testified that she paid her father $100.00 (not $26,000.00) "in the neighborhood of the time the deed was made," and her sister, Mrs. Hayes, testified that she could not remember paying the $1.00 consideration recited in the deed to her. She did not assert that any larger sum was paid by her. The District Judge correctly held that, in any event, the payment of these nominal amounts would not convert the gifts to transfers for a valuable consideration.

A contention not urged in the District Court but raised now was that the leases back to the father, made shortly after the execution of the deeds, constituted an additional consideration and removed the transfers from the category of gifts. There is no evidence as to the adequacy or in-

adequacy of the rental, and if we were to assume that the reserved rental was less than the rental value, it would merely reduce the amount of the gifts transferred by the deeds and would not convert the gifts into transfers for a valuable consideration.

In oral argument the suggestion was advanced that the grantor of a gift deed might be estopped from asserting the invalidity of the transfer to which he was a party; and that the Government can stand in no better position than the grantor. Were the Government in no better position than the grantor—a point we need not decide here—the decisions of the Supreme Court of North Carolina, to which we look for the proper interpretation of the statute, make it clear that gift deeds, if not recorded within the statutory period, are void even as between the parties. *Winstead* v. *Woolard*, 28 S.E. 2d 507, 508, 223 N.C. 814 (1944), held, ". . . as between the parties thereto a deed of gift, not registered, is good during the two years after the making of it, but upon failure to register it within such time, it becomes void *ab initio* and title vests in the grantors." To the same effect is *Justice* v. *Mitchell*, 78 S.E. 2d 122, 238 N.C. 364 (1953), and *Booth* v. *Hariston*, 141 S.E. 480, 195 N.C. 8 (1928). In *Sprinkle* v. *Ponder*, 64 S.E. 2d 171, 233 N.C. 312 (1951), the grantor brought suit to set aside a gift deed to his wife, since deceased, the deed not having been recorded within two years. Although the case was remanded by the appellate court on an evidence point, neither the litigants nor the Court intimated that the grantor plaintiff would be precluded from asserting the invalidity of the deed. See also *Harris* v. *Briley*, 94 S.E. 2d 476, 244 N.C. 526 (1956), where the heirs of the grantor successfully attacked the validity of a gift deed not recorded within the statutory period.

As we conclude that the District Court did not err in directing a verdict for the defendant, the judgment is

Affirmed.